

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of
DON BAXTER, INC.

Appearances:

For Appellant: Neil R. Bersch, Certified Public Accountant

For Respondent: Burl D. Lack, Chief Counsel

O P I N I O N

This appeal is made pursuant to Section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board denying the claims of Don Baxter, Inc., for refund of franchise tax in the amounts of \$30.46, \$878.60, \$1,332.46 and \$1,157.63 for the taxable years 1955, 1956, 1957, and 1958, respectively.

Appellant, during the income years 1954 through 1957, paid taxes to Brazil, Italy, Mexico, Argentina and the Philippines. These taxes were withheld from royalties it received from sources within those countries. In general, the levies imposed a flat rate on the gross amount of the royalties without any allowance for deductions,

Appellant filed the instant claims for refund on the ground that it is entitled to deduct these foreign taxes under Section 24345 of the Revenue and Taxation Code. That section provides in part:

There shall be allowed as a deduction -

(a) Taxes or licenses paid or accrued during the income year except:

* * *

(2) Taxes on or according to or measured by income or profits paid or accrued within the income year imposed by authority of

(A) The Government of the United States or any foreign country;...

The Franchise Tax Board denied Appellant's claims on the theory that the foreign taxes in question were imposed on, according to or measured by income or profits within the meaning of subdivision (a)(2)(A) and were thus excepted from the deduction permitted by Section 24345.

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Appellant contends that since the foreign taxes are laid upon the gross amount of the royalties without benefit of any deductions, they are gross receipts taxes and not income taxes.

In support of its position, Appellant relies upon our decisions in the Appeal of Georgica Guettler, Cal. St. Bd. of Equal., April 1, 1953, 1 CCH Cal. Tax Cas. Par. 200-212, 3 P-H State & Local Tax Serv. Cal. Par. 58079, and the Appeals of Edward Meltzer and Frieda Liffman Meltzer, Cal. St. Bd. of Equal., April 1, 1953, 1 CCH Cal. Tax Cas. Par. 200-213, 3 P-H State & Local Tax Serv. Cal. Par. 58081, wherein we held that a Canadian tax was a gross receipts tax, deductible under provisions identical to those of Section 243~~4~~5. Those decisions turned upon the fact that the measure of the Canadian tax was the gross amount not only of rents and royalties but of payments for anything used or sold in Canada. Where such payments were consideration for the sale of property, part of the receipts represented a return of capital. As we pointed out in those decisions, "gross receipts" include such returns of capital while "income," as the term is used in our law, does not. The fact that a tax is imposed upon the gross amount of royalties without benefit of any deductions does not establish that the tax is upon gross receipts as opposed to a tax on income. (Santa Eulalia Mining Co., 2 T.C. 241, appeal dismissed, 142 F. 2d 450; Seatrains Lines, Inc., 46 B.T.A. 1076.)

Appellant, who must prove the nature of the foreign tax laws (Elgin National Watch Co., 17 B.T.A. 339, 362, Havana Electric Ry., Light & Pwr. Co., 29 B.T.A. 1151), has subsequent to the hearing of this appeal submitted translated excerpts from them. We shall separately discuss the excerpts from each of the foreign laws.

Argentina. The portion of the Argentine law upon which Appellant relies is a statement that "the withholding of the tax shall be made without deductions for nontaxable minimum and family allowances,..." This provision, however, does not establish that the tax is upon gross receipts rather than income. On the contrary, our review of the other provisions of the Argentine law indicates clearly that the tax is upon net income and not upon gross receipts. (See Articles 1, 2, 3, 43, 44, 61, 62 and 65 of the Argentine law as reported in Foreign Tax Law Association, Inc., Argentine Income Tax Service.)

Mexico. Appellant cites a portion of the Mexican law which provides that "The basis for payment of the tax ... is the total income received by the taxpayer..." This, however, only tends to confirm the position of Respondent that the tax is on, according to or measured by income.

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Philippines. Appellant emphasizes a portion of the Philippine law which provides for withholding a tax from "annual or periodical gains, profits, and income...." Again, this language tends to confirm that the tax is upon income, either gross or net.

Italy. The material part of the excerpt submitted by Appellant provides:

Article 128. Withholding on account

Anyone paying foreigners . . . royalties or fees for transfer of concession of patents, designs, processes, formulas, trademarks and such like .. is required to withhold on two thirds of the sums paid for taxes due by the recipient:

a. To the extent of 18% when the payment is made to commercial concerns as royalties, or fees and other payments for transfer or concession of use of patents, designs, processes, formulas or trademarks and such.

After examining a translation of all of the provisions of the pertinent Italian law, it is apparent to us that the tax is upon net income, and is not intended to apply to a return of capital, (See Articles 81, 85, 88 and 91 as reported in Foreign Tax Law Association, Inc., Italian Income Tax Reporter Service.)

Brazil. So far as is relevant, the excerpt supplied by Appellant reads as follows:

Art. 97- The following are subject to deduction of the tax at the rate of 25% (twenty five per cent):

* * *

III - revenues ... such as those arising from the utilization of industries and commercial trade marks, invention patents and manufacturing processes or formulae, or the proceeds from the alienation, under any head, of such property,...

* * *

Paragraph 5 - The percentages referred to in this article shall be incident on the gross revenues,...

It is not clear whether the above quotation is from the law or the regulations, nor is it clear that the provisions applied during the years in issue. Other sources indicate that Article 97 of the Brazilian tax law contains no reference to "proceeds from the alienation" of property. (See Foreign Tax Law Association, Inc., Brazilian Income Tax Service; Rev. Rul. 60-56, 1960-1 Cum. Bull. 274; Rev. Rul. 59-70, 1959-1 Cum. Bull. 186.)

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Apparently the Brazilian Income Tax Division has taken the position that every transfer of rights in intangible property such as a patent is in the nature of a license and that the consideration constitutes royalties subject to withholding tax under Article 97, but the Brazilian Tax Court has held that a permanent and final transfer of such rights is a sale and that the consideration is not taxable. (Harvard Law School, World Tax Series, Brazil, pp. 220, 221.) In the volume just cited it is stated at page 217, without qualification, that:

Although the withholding tax imposed on nonresidents is computed on gross income, it is not applied to payments which are in the nature of gross receipts or which constitute a return of capital.

The United States Internal Revenue Service, moreover, has ruled that the Brazilian tax in question is an income tax. (Rev. Rul. 6055 1960-1 Cum. Bull. 274; Rev. Rul. 59-70, 1959-1 Cum. Bull. 186.) These rulings were made with respect to amendments of the Brazilian law as decreed on January 13, 1955, and December 31, 1956, dates which are within the period here involved. Based upon the available authority, we conclude that the Brazilian tax paid by Appellant was upon income,

Since Appellant has not established that any of the applicable foreign laws imposed a tax upon gross receipts rather than a tax on, according to or measured by income, we must sustain Respondent's position.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board denying the claims of Don Baxter, Inc., for refund of franchise tax in the amounts of \$30.46,

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\$878.60, \$1,332.46 and \$1,157.63 for the taxable years 1955, 1956, 1957 and 1958, respectively, be and the same is hereby sustained.

Done at Pasadena, California, this 21st day of October, 1963, by the State Board of Equalization.

John W. Lynch, Chairman
Geo. R. Reilly, Member
Paul R. Leake, Member
Richard Nevins, Member
 , Member

ATTEST: H. F. Freeman, Executive Secretary